# Firms in developing countries

## Lecture 9/2: Family Firms and Firms in Rural Area

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# Overview

- Family businesses are very common in Latin America, Africa and the Middle East, Asia (except Japan), and in parts of western Europe.
- Why are family firms so prevalent? Core debate: whether family firms evolve as an efficient response to the institutional and market environments, or whether they are an outcome of cultural norms that might be costly for corporate decisions and economic outcomes
- Expansion of nonagricultural activities is one of the most promising ways to alleviate rural poverty.
- There are some limitations for nonfarm expansion in rural: most nonfarm activities located in urban centers, limited market size and high transportation cost in rural.

# Why family firms?

- Family control creates comparative advantage for firms, achieving better outcomes over nonfamily firms
- Many family firms operate in longevity and become very successful.
- They view their family firms as trust and legacy they are responsible for, rather than something they own.
- Trust between family members can be a substitute for missing governance and contractual enforcement, especially in countries with weak legal structures.
- When human capital is transferred within family and when there is strong within-family managerial talent, it is more beneficial in doing business with family involvement.
- Family firms' connections may help preferential access to public resources, especially in high levels of corruption economy.

# What do the data say?

- How much systematic evidence is there for the economic superiority of family controlled business?
  - Not a lot, but several studies show that family firms underperform relative to nonfamily firms.
  - But, the result maybe be subject to many possible omitted variable and selection biases.
- Countries where family is generally regarded as more important have lower levels of per capita GDP, smaller firms, a higher fraction of self-employed, fewer publicly traded firms, and a smaller fraction of total market value controlled by families.
- Data from the World Values Survey: Family values
  - (un)importance of family, parental duty to child, respect for parents, obedience of child, independence of child

# Family values and economic development

- Countries with stronger family ties have lower GDP per capita.
  - Controlling for human capital weakens the effect of family values on GDP.

*Table 2*

**GDP Per Capita and Family Values**

| | *Dependent variable: log(GDP per capita) in 1990* | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | *(1)* | *(2)* | *(3)* | *(4)* | *(5)* | *(6)* | *(7)* | *(8)* | *(9)* | *(10)* |
| Strength of family | −.37 | −.15 | | | | | | | −.34 | −.15 |
| | (.06) | (.06) | | | | | | | (.07) | (.07) |
| Log(schooling) | | 1.11 | 1.35 | 1.33 | 1.07 | 1.16 | 1.43 | | | 1.08 |
| | | (.20) | (.17) | (.18) | (.21) | (.19) | (.17) | | | (.21) |
| (Un)importance of family | | | 2.36 | | | | | | | |
| | | | (1.12) | | | | | | | |
| Parental duty to child | | | | −1.41 | | | | | | |
| | | | | (.88) | | | | | | |
| Respect for parents | | | | | −1.87 | | | | | |
| | | | | | (.69) | | | | | |
| Obedience of child | | | | | | −1.62 | | | | |
| | | | | | | (.64) | | | | |
| Independence of child | | | | | | | .07 | | | |
| | | | | | | | (.48) | | | |
| Trust | | | | | | | | 3.01 | .50 | .31 |
| | | | | | | | | (.74) | (.85) | (.70) |
| $R^2$ | .47 | .70 | .68 | .66 | .69 | .69 | .64 | .25 | .47 | .70 |
| *N* | 51 | 52 | 46 | 46 | 46 | 46 | 46 | 52 | 51 | 46 |

*Notes:* The unit of observation is a country. All family values, except "strength of family," are country means directly computed from the World Values Survey. "Strength of family" is the first component from a principal component analysis of the 5 family values described in Table 1. "Schooling" is defined as average schooling years in the total population over age 25 as of 1985. Ordinary least squares estimations; standard errors are reported in parentheses.

# Family values or Trust?

- Putnam (1995) and Fukuyama (1995) support that trust will help countries to develop the large-scale organizations in a modern economy.
- Knack and Keefer (1997) and La Porta et al. (1997) explored cross-country data and found a positive correlation between trust and economic development.
- Table 2 column 8-10 explain how much of the correlation between GDP and family values can be explained away if we include trust as an additional control.
    - Coefficient on family values in col. 9-10 barely changes compared to that in col.1-2. No statistically siginificant correlation between GDP and trust after controlling on family values.
    - The importance of trust for economic outcomes is a function of family values in a society.

# Family values

- Table 4: Family norms are fairly stable over the short to medium run. It does not likely appear that family values change rapidly in response to economic change.
- Table 5 shows moderate support to the idea that stronger family values should be mainly interpreted as a reflection of weak formal institutions
  - Then, the correlations we see in Table 2 may be the results of omitted formal institutions.
  - Family values may be an outcome rather than a driver of economic development.

# Rural Industry

- Most rural manufacturing firms are rice mills, sugar refining, firms that use perishable raw materials - food processing, firms producing raw materials for construction
- Most of them are small and medium scale
- Factors affecting the existence of rural industry
  - Backward and forward linkage of the agricultural sector
  - Agricultural income
  - Urban demand
  - Effect of seasonality
  - Limited extent of the market

# Rural Industry

- Backward & forward linkage
  - Export-oriented agricultural sector induces the growth of agricultural machinery manufacturing and other input-supplying activities
  - Agricultural processing
  - Transportation sector
- Agricultural income
  - Income increase will lead to more demand for goods & services
  - Growth of village grocery stores is consistent with the rising-income hypothesis
  - When income rises, there is a change in consumption patterns: food to non-food, durable to non-durable goods, traditional to higher-value-added goods

# Rural Industry

- Urban demand
  - Farmers in the provinces adjacent to Bangkok have the highest proportion of income from non-agricultural sector
  - Proximity to the market
- Effect of seasonality
  - Pattern of rural labor: peak demand in wet season, low demand in long dry season
  - Nonfarm capital equipment is idle during the wet season
- Limited extent of the market
  - Rural villages are small and infrastructure is lacking
  - Most nonfarm activities fail to expand because their size and growth are limited by the market size
  - Firm size tends to be larger if they are Bangkok oriented or export oriented